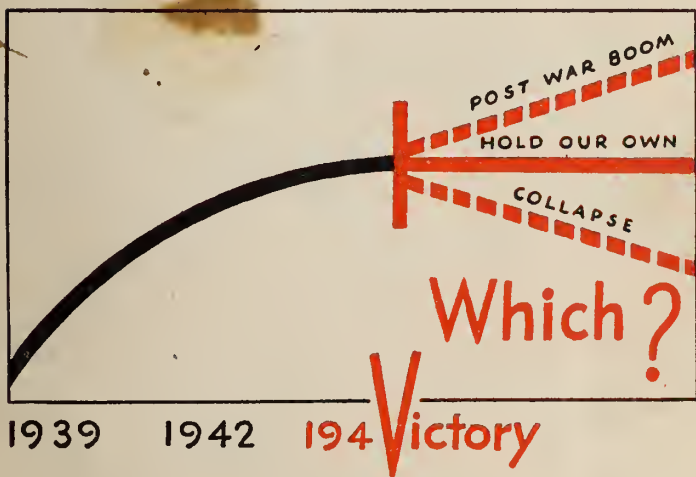


DEFICIT SPENDING and Private Enterprise

POST-WAR READJUSTMENTS

★ BULLETN NO. 8 ★



CHAMBER of COMMERCE of the UNITED
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DEFICIT SPENDING and Private Enterprise

Argument for an
Adjusted, Instead of a Planned, Post-War Economy

by

DR. L. ALBERT HAHN
NEW YORK CITY

POST-WAR READJUSTMENTS
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CHAMBER OF COMMERCE
OF THE UNITED STATES OF AMERICA
Washington, D. C.

INTRODUCTION

THIS BULLETIN takes issue with a book and a philosophy which have had a deep influence on employment and the welfare of the people of the United States in the 1930's.

The book, "The General Theory of Employment, Interest and Money," by John Maynard Keynes, promoted the view that well-developed industrial civilizations are constantly short of sufficient private investment opportunities to absorb the money savings of society. This alleged economic maturity and perpetual oversavings are to be corrected by driving the interest rate down to zero, by high taxes on large incomes, by vast governmental expenditures through borrowing and with fiat money if necessary, and by enormous public works—useful or useless.

Keynes, so greatly admired in this country but heavily discounted in his own land—England—was so enamoured of the new key to perpetual prosperity which he had found that he wrote:

"Ancient Egypt was doubly fortunate, and doubtless owed to this its fabled wealth, in that it possessed *two* activities, namely, pyramid-building as well as the search for the precious metals, the fruits of which, since they could not serve the needs of man by being consumed, did not stale with abundance. The Middle Ages built cathedrals and sang dirges. Two pyramids, two masses for the dead, are twice as good as one; but not so two railways from London to York."

Again, he says:

"In so far as millionaires find their satisfaction in building mighty mansions to contain their bodies when alive

and pyramids to shelter them after death, or, repenting of their sins, erect cathedrals and endow monasteries or foreign missions, the day when abundance of capital will interfere with abundance of output may be postponed. 'To dig holes in the ground,' paid for out of savings, will increase, not only employment, but the real national dividend of useful goods and services."

This philosophy, embracing many assumptions and tenets of doubtful validity, raises question as to how far government will have to invade the private sector of our economy in order to find sufficient opportunities for public "investment" and public works. Likewise, the financing of such work raises question as to where the money is to come from; but this, we are told, is no problem because a public debt can be no burden on society since "we owe it to ourselves."

Whether monetary manipulations through the expenditures of public funds can liquidate maladjustments in the cost-price structure and thus restore the private incentive to expand, is an issue not faced by Keynes and his followers.

This Bulletin is based on an address by Dr. L. Albert Hahn at Harvard University. The author for many years was an academic and practicing economist in Europe. His publications attracted wide attention. He was one of the first to criticize the ill-fated monetary policy which led to the great inflation of the 1920's and paved the way for the subsequent Hitler movement.

In 1920, antedating Keynes, Dr. Hahn published a book espousing the essential ideas subsequently developed by Keynes and his followers. Upon further experience and close observation of events in Europe, he came to the conclusion that his earlier ideas and these, as subsequently developed by Keynes, were essentially wrong and dangerous to a free economy.

His analysis is herein presented to give the American people the benefit of his thinking and experience in regard to this important problem with the hope that the issues may be seen more clearly and that out of the conflicting views we may set our course in sound and workable directions.

EMERSON P. SCHMIDT, *Economist*
Committee on Economic Policy

February, 1944.

DEFICIT SPENDING and Private Enterprise

ARGUMENTS FOR AN

Adjusted, Instead of a Planned, Post-War Economy

WHEN ANYBODY who has been in this country for only a short time undertakes to talk about specific American problems, he has to give an explanation for doing so. For he cannot pretend to compete, even in the slightest degree, in knowledge of the relevant facts with men who have lived in this country all their lives.

My excuse is that perhaps it may be of interest to you to hear about the reactions which certain of your ideas and plans concerning post-war economy produce in one who comes from the outside world, and especially from an island of free economy, namely, Switzerland. For this country in which I lived through the last ten years has preserved, not only with regard to its economic structure, but even more as to the prevailing ideologies, a unique character which appears to some observers as enviable for its freedom as it appears to others outmoded and old-fashioned.

Even so, I cannot hope that you will glean from my paper any new ideas or advice for managing the economic post-war problems. But, perhaps, after having heard my paper, you will agree with a friend of mine who once said: "What you say, is entirely stupid; but every time I listen to your nonsense, I myself get some good ideas!"

I should like very much to begin with the question: What would be an orthodox economist's reaction to the plans for post-war economy which are now being prepared in so great a number?

He would be greatly surprised that the government's

intervention seems to be, to the planners, such a usual and customary thing. Furthermore, there are two facts he would not understand since they are so very strange to his world of thought. The one is the fact that in all plans for spending, the question of adjustment of cost and prices seems to play such a very minor role. The other is the ease with which one looks forward to a further gigantic increase of government debt which is to be incurred to avoid unemployment after the war.

I Keynes' Influence

IN MODERN PLANS for post-war economy, the temporary character of governmental interference is rarely mentioned and, if so, seemingly with subconscious regret. Adjustments, including wages and taxes, are hardly mentioned at all. The reasons are, at least partially, of course, political; but they have, so far as I can judge, their roots even more in the theoretical conception of unemployment and depression which prevails. Following this conception, an adjustment of costs and especially of wages would not relieve the depression but rather deepen it. For in accordance with this conception, the unemployment of the last decade and also the possible post-war unemployment are caused by chronic oversaving and chronic underinvestment. *It is Keynes' world of ideas which dominates.*

One can, of course, take the position that these ideas are so dominant today that there is no use discussing them any more. This position would not as such, be untenable. It is a well-known sociological phenomenon that theories, even basically incorrect, if once accepted, can turn into an

independent power which leads to the effect to which the original facts as such would never have led—thus seemingly proving the correctness of the original theory. The classic example for such an effect of a theory is Karl Marx' "*Klassenkampf*" conception (class struggle) which caused the development of class-consciousness rather than vice versa. And Keynes' general theory compares with Marx' *Kapital* in that it is written in an unclear way, containing many contradictions, based on statements which are obviously wrong, and in that it is entirely incomprehensible to an average person. But indistinctness seems to appeal to many people rather than to deter them.

One could, of course, conclude that Keynes' ideas are already so dominant, especially in this country, that people are just feeling and acting in accordance with Keynes' theory, of which, as you know, one of the chief assumptions is that lowering of wages normally does not increase employment but unemployment. (The General Theory of Employment, Interest and Money, pg. 261 ff.)

If one were of this opinion—which I personally do not share after witnessing the rise and destruction of Marxist ideologies in Europe through propaganda and anti-propaganda—it would be of no use discussing Keynes' ideas any longer. For wages and costs would be rigid, not by natural or economic law, but by the acceptance of Keynes thought which would prevent their adjustment. And the effect of this rigidity of wages and costs would have to be considered by economic theory in the same light as the effects of floods and bad harvests—things which have to be accepted.

Now I don't want to examine how dominant Keynes' ideas are in this country; I want just to remark: One of the facts which particularly strikes somebody coming

from the outside world is that Keynesianism seems to be so widely accepted among economists and in practice in this country. This differs so strongly from the state of affairs in Europe, particularly in those places of Europe where free economic analysis was or is allowed. The so-called Austrian School, existing as such until the “*Anschluss*” in 1938, seems to have been distinctively against Keynes. And on the last island of Democracy and scientific freedom in continental Europe—in Switzerland—even today, Keynes’ theory is generally rejected, as you may learn from the new book of Roepke, *Gesellschaftskrise der Gegenwart*, 1942.

Thus let us suppose that in this country it is not yet superfluous to discuss Keynes’ ideas.

II A Personal Remark

IF IN THE FOLLOWING I am going to express a very negative opinion about Keynes’ principal theories, this perhaps will be of more interest than the views of Keynes’ other opponents. For the average opponent of Keynes’ can be charged with exaggerated orthodoxy and unwillingness to criticize traditional views. This charge cannot be made against me. As those who are familiar with modern literature on economics know, in my book *Volkswirtschaftliche Theorie des Bankkredits* (Economic Theory of Bank Credit) as early as 1920 I set forth the essential ideas of Keynes, including the idea of eternal prosperity through monetary and credit manipulations and the idea of liquidity as being rewarded by interest payments; a fact

which, by the way, has never been mentioned by Keynes or his closer followers. My statements were made at that time against the nearly unanimous opposition of orthodox economic thinkers, who called me a modern John Law and charged my theories as being a relapse into a pre-classic state of thought when the distinction between capital and money was not yet clearly established. As a matter of fact, as I put it once in a criticism of Keynes, "All that is wrong and exaggerated in Keynes, has been said much earlier and much clearer by myself."

Generally speaking, I do not feel very happy to see my early ideas so widely accepted under the influence of Keynes and his school. I would rather feel inclined to exclaim with Wallenstein, "God protect me from my friends, from my enemies I will protect myself." Nevertheless, I think, one cannot charge me with exaggerated orthodoxy if I state that, in my opinion, Keynes has not discovered the source of unemployment but has created one by supporting economic policies which rely on artificial and governmental, rather than on natural adjustments and private prosperity.

In Europe, and especially in Germany and Austria, we have analyzed and stressed the strong effects of monetary and credit measures on economy and have demonstrated that the classic theory—valid for a fictitious static world—is not sufficient to explain a dynamic reality. After a short period of over-enthusiasm concerning the implication of the new ideas, however, we, and I myself, have found out the limits within which money and credit can and should be used. We have demonstrated—compare especially my article on *Kredit* in the *Handwoerterbuch der Staatswissenschaften* — that monetary and credit manipulations are only *one* means to create changes in the magnitude of production. Furthermore, we have

shown that monetary manipulations and governmental intervention in general do not create employment by a miracle, but that somebody has to pay for the treat. Thus the pendulum did not swing to the pre-classic state of thought when indeed the distinction between capital and money was no yet clearly established and phenomena like John Law were possible. Instead, a true synthesis between the pre-classic inflationistic and the classic orthodox conception was developed. You will understand that I hope, therefore, that also in this country a synthesis of orthodox and modern views can be found and that the entrenchment of an extreme inflationistic conception will be avoided.

III Keynes' Theory

AS EVERYBODY KNOWS, Keynes rests his case on an over-saving-underinvestment theory of secular-structural character to explain depressions. His thesis is: in a mature economy new savings are excessive, while new investment possibilities are small. The resulting gap between saving and investment leads to a deficit of active purchasing power, i.e., deflation. The excessive saving is rooted in the increasing wealth and income of modern times while the underinvestment has its cause in the lack of possibilities for new investment with sufficient yield. This is the kernel of Keynes' theories if one deprives them of their very complicated shell.

It seems difficult to examine these ideas objectively without being impressed by Keynes' prestige and also without succumbing to the atmosphere created by the

fact that his ideas have such an appeal to strong political groups. I personally have never been able to understand the reason why Keynes' theory should be considered as anything else than a variety of the old under-consumption theories. For, in principle, it is the same whether the consumer does not spend his money or whether the entrepreneur who could borrow money from him for purchasing machines etc., is reluctant to do so. Neither can I understand why the recognized objections against the under-consumption theories should not be valid against Keynes.

There have been under-consumption theories as long as men have observed that goods and services found no buyers. Especially in the 19th century—by Malthus in 1820, by the fathers of Socialism, Simon de Sismondi in 1819 and Rodbertus in 1869—the under-consumption theory has been presented over and over again. But in the beginning of our century it seemed, after some late presentations, so obsolete that nobody considered it worthwhile to refute it, until Keynes again made it presentable.

Under-consumption theories are the naive explanations for depressions. For how could stagnation be explained more simply than by the fact that consumers are not able or willing to buy?

IV The Post-war Depression— Government Stops Buying

IF ONE WISHES to judge a new therapy one has to find out the illness involved and the traditional methods for its

treatment. The sickness to be cured is a post-war depression. For, during wartime, we experience the normal business cycle boom, a fact, which, although everybody talks of a war boom, is very often overlooked.

When speaking of the post-war depression one ought to make clear which phase of the economic post-war development one has in mind. Unfortunately, this is often omitted. This explains why sometimes plans for avoiding post-war inflation and plans for avoiding post-war deflation are put forward the very same day.

If history should repeat itself to some extent, the war will be followed by a readjustment crisis which, however, although sharp, will be of no considerable duration. This is not the crisis one generally has in mind when one thinks of post-war difficulties. Most probably, this crisis very soon will be followed by what is frequently called a replacement boom. This boom is caused by the fact that needs and, even more important, means for purchasing have accumulated during a past production period, namely, during the war. The money earned during the war but not spent because of restrictions, sets the monetary circle in motion. After this replacement boom, normal life begins again. Again, only those goods can be produced which can be sold to those contributing to the production of this same production period. Then, according to all precedents, the actual post-war depression, which was only postponed by the replacement boom, will begin. The inability of the American economic system to escape the semi-depression which prevailed before the war and to absorb its unemployed to a reasonable extent, will again become a problem.

This post-war depression, naturally, would be rooted ultimately in the cessation of governmental demand for armaments. This, in turn, would be caused by the fact

that the country had discontinued its payments of high prices for military protection. Thus the cost-profit margin of the governmental enterprise is eliminated. The entire structure of the business cycle boom collapses. Prices, employment, and the quantity of circulating money fall. According to the traditional pattern there occurs also a severe money and credit stringency with high interest rates as a result of the money and credit deflation. However, it is very doubtful whether such a stringency will develop in this era of artificially easy money.

V Liquidation and New Rise

FOLLOWING THE TRADITIONAL business cycle theory, the previous boom is then being liquidated. And this also happens in reality if the liquidation is not postponed or prohibited through rigidity of prices and wages or through governmental attempts to prolong the boom by spending. The enterprises which are only profitable during the war boom stop running, the price level falls, and costs, especially wages, decline. Moreover, wages have to decline even further than prices in order that an increasing profit margin may make new ventures profitable and hence possible. A new business cycle starts, and the deflationary process, which was caused by the liquidation of the previous business cycle, is relieved by the inflationary process of the new ascending cycle. Prices and employment rise.

VI Legitimate Means of Stabilization

EVEN THE FOLLOWERS of the traditional business cycle theories admit that governments should try, under certain conditions, to interfere with the business cycle. In general, all those measures which come under the heading "means of stabilizing the business cycle" are acceptable. The various authorities disagree only as to the extent of the measures to be applied. All of them are in favor of easing money, many of them of governmental spending. The aim is to straighten out the downward movement of prices so that such enterprises as are destined for survival under normal conditions, will not be killed.

Here I should again like to make a personal remark, especially so that you do not consider me to be the wild deflationist I might appear to be. During the years 1930-33 in Germany I tried with all my power, in speech and in print, to convince the German authorities and the German public of the disastrous economic and political consequences of the deflationary policy of the Bruening government, and of the Reichsbank under its President Luther, a policy which was, in my opinion, one of the chief reasons for the success of the Nazi revolution. I remember a conference which I had with President Luther, in his office in Berlin, I think it was in the beginning of 1932. I urged him not to stick to his deflationary policy, but to ease credit and to try to raise prices after devaluating the Mark in relation to the £, instead of depressing internal prices, so that German export goods could compete on the world market with the goods cheapened through the £ devaluation. "And," I continued verbally, "if you don't follow a policy of monetary alleviation,

the party of the debtors will join the party of the Nazis and will throw you out of office"—a prediction which, as you know, later came true, but which President Luther, otherwise an extremely clever and shrewd man, did not understand. He was wholly unaware of the revolution-producing power of falling prices, a power, which in history has so often proved itself, and for fear of which Solon, as you know, introduced his *Seisachtheia* (reduction of debt) coupled with, what sometimes is not known, the devaluation of the Drachma in Athens.

What was, at that time, my aim and is the aim of all those who advocate governmental measures to lessen and to shorten the depression, is to eliminate specific phenomena of depression: in the first place, to eliminate the abnormally high interest rates prevailing in the depression, at least as far as it follows the classical pattern and, secondly, in the field of psychology, to remove the pessimism of the population with its cumulative effects.

VII **Structural Readjustments vs. Cyclical Mitigation**

THE AIM OF SUCH MEASURES, however, is always to eliminate *business cycle disturbances* and not *structural disturbances*, and especially structural unemployment. In other words, those who follow the traditional opinion about the fight against depression and business cycle stabilization in general never mean to say that the adjustment of economic factors, like costs of production, to the changing situation is superfluous. They believe that by

all means such factors must be heeded that give the private entrepreneur a natural stimulus to replace the previous governmental activity. Therefore, they do not want to prevent the reduction of costs, especially of taxes and wages, in relation to prices when this reduction seems necessary, to make enterprises profitable in normal times. They merely wish to prevent an excessive downward movement of the price level—and an upward movement of the interest rates which anyhow will be reversed in the recovery period of the following business cycle. But they do not want to prevent the reduction of a cost level bearable only in excessive boom times and unbearable in normal times.

This means for the future considering the extent of unemployment prevailing before the war: adjustment of cost remains necessary in so far as the cost-profit relation is structurally disturbed, i.e., a natural profitability must be reestablished. Governmental interference and spending are justified only as temporary measures and as long as they do not interfere with the adjustment of the economic system to a new equilibrium, i.e., to a new relation between cost and prices.

VIII The Classic Theory of Unemployment

THE CLASSIC THEORY was concerned with long-term unemployment rather than with unemployment during cyclic depressions of which it took little notice.

Following the opinion of the classicist—this group em-

bracing very many opinions which differ as to details—there cannot be any factors of production and especially of labor which are not absorbed by demand. For the productive factors—labor, capital and land—lower their absolute and relative prices until they are again absorbed in the economy. The so-called distribution theory of the classes (the theory which explains the distribution of the social product among the production factors) as well as their doctrine of full employment were based on this theory.

Considering the classic theory of distribution as correct, there can be only one reason why labor is not employed, namely: Labor does not want to compete on the market of productive factors *below* a certain remuneration, so that unemployed labor is withheld from the market. The only theoretically sufficient explanation that goods are not being taken from the buyers lies in the fact that sellers have set a price which is above the price prevailing in case of free competition. Prices fixed above market prices drive away buyers as ceiling prices drive away sellers.

IX The Big Bakery

TO MAKE IT ABSOLUTELY CLEAR how, according to the classic theory, structural unemployment comes about, let us use the following analogy:

In a capitalistic economy, the economic process consists of an exchange of labor for the products of labor. The use of money makes this process somewhat more com-

plicated without changing its basic character. The laborers receive money from the entrepreneur so the circle of money is closed.

Now, the entire production of a country has been often compared with the baking of a gigantic cake. Let us assume that the national cake consists of one thousand slices and that one hundred bakers participate in the baking process. If a single baker demands more than ten slices of the cake as his remuneration, the cake obviously cannot be baked unless others take less. If the bakers lower their demands for remuneration, the baking can proceed. But if each insists upon demanding more than ten slices, the cake cannot be baked although there are bakers unemployed—which proves the theory of unemployment, through non-profitability, as being correct.

X The Island of the Unemployed

A FURTHER PROOF of the correctness of this theory can be gained through examining how things would develop in the so-called economy of natural exchange.

Let us consider the following: The unemployed form, to a certain extent, a state within the state. Suppose the authorities should decide to settle these people in a territory outside the country. What would develop economically on such an "island of unemployed?" Probably very soon small cooperatives would be founded. They would produce for the needs of their members. The products would be distributed among the members and, as in every closed domestic economy, over-production would not occur. Very

soon entrepreneurs would appear who would figure out the future demands for and the future prices of the products and simultaneously the amounts which consequently could be spent for the cost of production. The necessary capital would be borrowed, at rates close to zero, from the homeland which allegedly has capital in excess of need. Thus, very soon, small capitalistic production would develop. Unemployment would not exist on this island; for everybody would be satisfied with the products of his work as compensation for his work. There would be full employment with a relatively low standard of living. This explains also why, in certain organizations of self-help, such as camps, an economic life develops which cannot develop outside the camp.

In putting forward this classic theory of unemployment I should like to remark that it is naturally not my intention to give an opinion as to whether and if so, which wages are too high in the United States. Nor do I want to examine the question, whether raising productivity of labor would make wage adjustments unnecessary nor the very many other important questions in this connection. All these questions presuppose a knowledge of American labor conditions which I certainly lack. Neither do I deal with the unemployment creating power of industrial monopolies which are just as dangerous as the labor monopolies since they raise the costs of production in industries dependent on them and stimulate demands for wage increases. I am dealing here only with the theory of unemployment in general, i.e., with the basic factors which create unemployment.

XI The Unemployment in Germany after 1927

IN CONNECTION with the classic unemployment theory it might interest you that the validity or non-validity of this theory was discussed thoroughly in Germany after 1927 when unemployment began to rise at a moment when business activity remained high. At that time an article by Professor Gustav Cassel, of Sweden, appeared, which aroused great interest all over the world. This article, *Selbstkritik! Die Sinnlosigkeit der deutschen Arbeitslosenpolitik* (The Senselessness of the German Unemployment Policy) explained how senseless it was to keep the wages of the employed high and to pay subsidies out of the income of the employed to the unemployed, instead of letting the whole population work at adjusted wage rates.

You will find a summary of the response to this article in the scientific and political world in Germany in my little booklet which appeared in 1930, *Ist Arbeitslosigkeit unvermeidlich?* (Is Unemployment Inevitable?). You will be astonished to find there that even scientists tending decidedly to the left, took a position in this discussion which makes them appear reactionary compared with many entrepreneurs in this country. I quote, just at random, a sentence from Emil Lederer who surely cannot be suspected of being inimical to labor. In his book, *Eine Untersuchung ueber die Armut der Nationen* (An Inquiry into the Poverty of Nations), 1927, he says with reference to the effect of economically non-justified wage rates: "A sharp decline of the economy will be the consequence. The unemployment allowances cannot be paid any longer and the artificially erected wage system must collapse inevitably. A valorization of labor, that is what this policy

would mean . . . is just not possible for the long run." I refer furthermore to a pamphlet, *Rentabilitaetskrise* (Veroeffentlichungen des Vereins deutscher Maschinen Bauanstalten, 1930) which demonstrated statistically the parallelism between rising wages and unemployment.

Nevertheless, the lowering of wages was opposed by the trade unions which even succeeded in obtaining substantial wage increases. Only later, at the bottom of the crisis, they conceded to extensive wage reductions—at a time when such reductions were entirely out of place because of their cumulative deflationary effect.

The arguments against wage-lowering were the well known arguments of the so-called purchasing power theory which stresses the importance of maintaining a high level of purchasing power—a theory which proved to be so fatal later on for France under Leon Blum who had adopted this theory up to its last consequences.

However, as far as economic science is concerned, one can state that in Europe the purchasing power theory was considered fundamentally wrong by an overwhelming majority of scholars. It was acknowledged of course that higher wages mean higher purchasing power. But for an enterprise it is not important to obtain large amounts of money, but rather an amount which, even if not absolutely high, covers the costs of production, of which wages are the most important part. In other words, not wages kept high or low by artificial means, but wages adjusted to the price structure of the economy are the prerequisites of functioning enterprises and consequently of a functioning economy.

XII Keynes Opposes Nominal Wage-Lowering and Favors Real Wage-Lowering

KEYNES AND HIS FOLLOWERS do not deny that high wages can play a decisive role in the creation of unemployment. Nevertheless, they are strictly opposed to nominal wage-lowering as a means of combatting unemployment. One of their reasons is that by wage-lowering, employment and incomes would rise and that this would mean over-saving. (General Theory, pgs. 97, 261.) In other words, they are fearful of the immediate, certain and favorable effects of wage adjustments, because an alleged unfavorable and remote effect—the increase of savings—may occur; surely this is a somewhat artificial and theoretical attitude. A second reason is based on the alleged fact that money wages are rigid whereas real wages are flexible. Through a reflationary policy, using lowering of interest rates and governmental spending, a lowering of real wages is supposed to be more easily obtained than through lowering of money wages. Well known, in this connection, is Keynes' statement that "having regard to human nature and our institutions, it can only be a foolish person who would prefer a flexible wage policy to a flexible money policy." (General Theory, pg. 268.) This statement is indeed fundamental for his whole theory of unemployment and explains his *paradoxical idea that employment is more or less a function of cost of capital rather than of labor*. When I dealt with Keynes' theory in an article published many years ago in Switzerland, I therefore opposed this theory, paraphrasing a European saying with the words: "Keynes transformed the evil of a rigid wage system into the virtue of an inflationary employment theory. *Formally*, his theory is correct; if one

assumes that wages are rigid, one cannot assume that employment increases by lowering them. But such a theory is not any longer a general theory of unemployment, but a very specific theory for a world with rigid wages, which certainly do not exist in all parts of the world. Therefore one would have to establish different business cycle theories, for countries with rigid wages and for countries with flexible wages."

The deeper reason for Keynes' recommendations of lowering the cost of capital instead of wages to combat unemployment lies, of course, in his conception of unemployment and deflation as caused through oversaving and underinvestment and thus "unvoluntarily" so far as labor is concerned. (pg. 15.)

XIII Keynes' Consumption Pessimism

THE OLDER under-consumption theories started from the idea that under-consumption of the high-income brackets was responsible for a lack of demand on the markets and thus for price recessions and unemployment.

Following Keynes, *every* increase in employment creates a gap between production and consumption because—following a fundamental "psychological rule"—what he calls the propensity to consume rises with increasing income but not proportionally to this increase (General Theory, pgs. 97, 261). This alleged gap leads him to a sort of fear of over-wealth which again leads him to such paradoxical things as the praise of pyramid building as means of syphoning away over-production.

If Keynes were right, *the world would have remained for centuries in a chronic structural over-production crisis*. But actually, the world has experienced *chiefly cyclical crises*, whereas structurally the increasing wealth was absorbed by an increasing living standard, especially of the masses, so that no permanent disturbances, chronic depressions, etc., occurred. Keynes' alleged law of consumption-deficit is based on the confusion between two entirely different conditions: The relative increase of the income of some classes compared with the income of others (the creation of so-called higher brackets) and the total increase of income of a community by increase of employment. In the former case, this alleged law is to a certain degree defensible; in the latter case it is just an assumption not justified by facts. Indeed, the masses have fought their fight for higher living standards with the aim to be able to *spend* more and not to save more. And the idea that former unemployed begin to save their earnings to any substantial degree, when they come into employment, is entirely unrealistic.

XIV Keynes' Investment Pessimism

IF REALLY EVERY INCREASE in employment must create a gap between income and consumption, then the system obviously can only work if the additional savings are used for increased purchases of capital goods or goods of remote consumption, i.e., for investments. According to Keynes, new opportunities for investments with sufficiently attractive yields do not arise in a modern economy

to an extent corresponding to the new savings. He thinks that modern economies have reached a stage of stagnation in which new methods of production with higher yields no longer develop, whereas the existing enterprises are saturated with capital. This is why he assumes that the necessary increase of investment has to be especially stimulated by an artificial easy-money policy and, if this does not work any longer, by public works financed by governmental deficit spending. (General Theory, pg. 320.)

XV The Facts Are Wrong

IT IS ALWAYS SUSPICIOUS if a theory is not conclusive in itself but needs a statement of facts for proof—as, in this case, a statement that the economy is saturated with capital. One could of course just as well state that seldom in economic history were new inventions made at such a speed and that seldom was there such an opportunity for exploitation of new inventions by investing capital. Indeed the saturation-stagnation idea seems rather absurd in this period of aircraft and electronic development—to mention only the most spectacular.

Every time I listen to a saturation theorist, I remember the old Berlin saying “First you draw a bogey and then you are terrified.” First, one makes new investments unprofitable, thus hindering the flow of savings to investments and, then, one is terrified by the alleged phenomenon of oversaving.

XVI No Employment Without New Investments?

BUT LET US ASSUME that there was indeed no opportunity for new investments giving an attractive yield so that there was really no additional want for capital or credit. And let us assume that there was an increasing gap between income and consumption of the employed workers. Even under these assumptions unemployment would not be explainable. There would remain the question: How is it that no production gets started for articles which would be consumed by the former unemployed? For we cannot seriously maintain that the unemployed, if converted into laborers, would save to such an extent that the products of their labor would not meet demand. Indeed, such an idea has never been presented.

The old under-consumption theory stated that the savings of the rich capitalist prevent a sale of the products—and this was incorrect, for at that time the borrowing entrepreneurs purchased these products only if the interest rates were not too high to discourage new enterprises. But nowadays, with the easy money interest rates prevailing, the capitalist would not get a substantial share of the new production anyhow, so that the saving of the rich cannot explain the stagnation of the demand of the poor. The saving of the poor explains the unemployment even less.

There remains, therefore, the old truth that under-consumption theories, of whatever variety, are not an explanation for depression and unemployment. We have to revert to the classic unemployment theory, in spite of all the violent attacks which this theory has met by Keynes. (General Theory, pg. 257 ff.)

XVII Unemployment Through Wage Increases

FOLLOWING THE THEORY of the classics a productive factor remains unused when too expensive in relation to the proceeds of the product. Therefore, unemployment can be created by wage increases enforced not by the situation of the labor market, but by governmental policies or collective action of labor. This case—although surely not an unrealistic one—is, so far as I can see, not treated in Keynes' work. Shall, also in this case, high wages be compensated either by interest rate lowering to make capital cheaper, or by inflation, to lower real wages in an alleged easy way, or by government works to replace private enterprises killed by too high wages? To answer this question with yes, means to imply that one class of the population should have not only the power—which it might have—but also the moral and scientifically approved justification to increase its income *ad libitum* at the expense of those interested in a stable value of money, in a fair return on capital and of the taxpayers in general. In such cases of structural unemployment—to turn Keynes' saying the other way round—it would only be a foolish person who would prefer a flexible monetary policy to a reduction of cost which would allow private enterprise to reabsorb the unemployed. *Indeed it is the strongest reproach one has to raise against Keynes and most of his followers that they do not distinguish sufficiently between the different sorts of unemployment and that they indiscriminately recommend monetary manipulations and governmental intervention to combat unemployment, i.e., cyclical measures even for structural maladjustments.* One asks in vain, must unemployment always

and anew be combatted through governmental intervention, even if caused through repeated wage demands which the stronger entrepreneurs can meet but which the weaker ones answer by closing down? If not, to what degree can unemployment be considered as not created by excessive wage demands and therefore relievable through governmental intervention? As far as I can see, this question is not discussed by Keynes. Or should he assume that wages monopolistically enforced represent always the equilibrium price for labor?

XVIII The Myth of the Real Wage Unconsciousness of Labor

BUT EVEN IF ONE WERE FOOLISH—and unjust—enough to wish to use inflationary measures or governmental deficit spending as a means to counteract wage increases, one would find that these measures would not work in the way Keynes thinks. For the basic assumption that “a gradual and automatic lowering of real wages as a result of rising prices” would not be “strongly resisted” by labor (pg. 264) is just not true. It is true that money wages have become rigid. But this rigidity is a one-sided one—a rigidity on the downside. On the upside, wages are perfectly flexible every time the living-cost index moves upward, and sometimes even without this. Labor watches very closely the real value of money wages and is not tricked out of its real wages by the fact that money wages do not go down. Labor is very real-wage-conscious—and this is not astonishing in times in which everybody seems

to carry a living-cost chart in his pocket. Every reflation would thus lead to a new wage increase and every new wage increase to new deficit spending.

So the assumption that real wages can be lowered smoothly by monetary manipulations is just a myth. A myth, however, is also the assumption that unemployed transformed into employed will create oversaving. A myth, furthermore, is the conception of the inevitable shortage in the modern economies of sufficiently profitable investment opportunities. It is to be admitted that these myths are presented in a highly sophisticated, complicated form with curves, mathematical formulas and all the rest of it which inspires deep respect. Nevertheless, every time I read Keynes' work, or works of similar kind, I remember the sentence of an old lawyer of my native town: "The dangerous thing in this world is that the intelligent people are so stupid."

Regarding Keynes' theory of employment and its working in the recent past I would like to state:

To impartial judgment, the idea that not wages but interest rates, and these alone, have to be lowered to incite full employment, has proved to be an illusion, as all policies have proved to be which try to enforce eternal prosperity through falsification of economic facts.

If somebody intended to create unemployment artificially in a private capitalistic economy, there would be virtually no better and theoretically more correct way of achieving this than to lower the price of capital and to raise the price of labor. For thus the demand for labor would not only be reduced through the high price of labor but also through labor-saving methods grown profitable by lowered interest rates.

XIX **A Sensible Economic Policy Must Aim at Real Wage Increases**

TO DEDUCE FROM ALL THIS that low wages should be the goal of economic policy would, of course, be absurd. In fact, it must be emphasized that every sensible economic policy must aim at increasing real wages. Indeed, the level of wages and the workman's standard of living are the measure of a nation's wealth and progress. However, the wage increase must be achieved in a natural way. It must be the outcome of an increase in labor's productive power through technical progress. Such progress is permanently promoted by the entrepreneurs in their own interest.

If, however, they are forced by labor to raise wages before labor's productive power has been augmented, the result will be completely different. Also in this case new labor-saving devices will be introduced. But labor thus saved may be definitely eliminated from production as more expensive than the new machinery the purchase of which can be financed at low interest rates. Unemployment will increase. New ventures will be harder to launch. Wages have risen, but only for the happy workmen who can stay on their jobs, while the others earn no wages at all. In short, neither artificially high nor artificially low wages, but *adjusted* wages are essential to permit reasonably full employment.

XX The Fetish of the Large National Income

ONE OF THE REASONS, if not the only one, why the raising of wages during periods of unemployment is not considered harmful in this country, not even by certain employers, lies in the fact that wage increases, *other things equal*, tend to increase the "national income." And an increase in the national income is considered, under all circumstances, as beneficial. One can say, without exaggeration, that the size of the national income has become a fetish which is worshipped without any one being aware as to what makes it so venerable.

This whole idea of national income is much more complex than generally is assumed. The incomes of the individuals which, added together, are supposed to constitute the national income are in reality figures which show the distribution of the social product among the individuals of the community. It is altogether doubtful whether there is any logical basis for the addition of data in the distribution sphere to obtain the national income which is clearly meant to be data of the production sphere.

Leaving aside this question, there are two facts especially which seem to be misunderstood. The first is: that the absolute size of the national income, as such, does not mean anything; its origin and distribution among the members of the community are the decisive features. If half of the population receives a total income of X, whereas the other half is unemployed, this situation is, for obvious political and social reasons, less favorable than if the whole population receives a total income of X or even a smaller one, and no unemployment exists. Just this latter is prevented through raising the national in-

come via artificial wage increases. Incidentally, it is very probable that lower wages in parts of the economy, after a transition period, would even bring about a national income higher than X, although the wages of some individuals might be smaller than before. But the attempt to attain larger *total* wages (and production) through lowering of the individual wages seems to be politically and psychologically impossible.

Germany started on a public works program late in 1932. In contrast to the policy in this country, wages at that time were frozen whereas prices were allowed to rise to a certain degree so that the characteristic phenomenon of a real boom, a rise of profit margin occurred, and the stimulating effect of this was felt. The result was that by the end of 1932 the reflation measures in Germany began to create employment which quickly rose after 1933 and before rearmament began.

The second mistake which is made in judging national income questions, is that little attention is paid to the way in which a given increase of the national income came about. Let us take an extreme example, the case of public works without any other aim than to provide employment—as e.g., the building of pyramids—ultimately with the money of the taxpayers. It is quite obvious that by such enterprises the “national income” can be raised to any desired level. In reality, the real national income does not increase at all, for the taxpayer, whose money is used to finance the public works, suffers sooner or later from a corresponding diminution of his spendable income, which alone is income in a material and not merely formal sense. In any case: The increase of the national income, as such, does not mean anything. The reason for the increase must be examined in every case.

XXI

The Myth of the Multiplier

IT IS WELL KNOWN that Keynes and his followers praise the multiplying effect of public investment spending on the absorption of unemployment. They assume that the spending of one million dollars would create employment worth three, four, or even more millions. For the one who first received the money would spend it again for his own needs and the one who would receive this money would spend it again, and so forth, until saving occurs, after which once more, governmental spending would have to substitute for the saved money.

This multiplier, which allegedly makes governmental spending so highly commendable, should be examined as to its place in the traditional scheme of economics. Instead, one usually considers it a newly discovered miracle-creating-power and indulges in statistical and mathematical speculations as to the power of multiplying under various conditions. I think that the future will consider the enormous literature which is concerned with the multiplier—if it will not be forgotten entirely at that time—as valueless as we consider, for instance, the discussions of the Middle Ages, as to how many angels can stand on the point of a needle.

The multiplier is nothing but the expression of the fact that our economy is a money-exchange economy: If somebody sells goods, he receives money, and with this money he again buys goods, i.e., there exists a cycle of money. Until Keynes, nobody thought it worth while to develop a special nomenclature for it. The denomination “multiplier,” in my opinion, misleads the public. This name implies a special advantage in governmental spendings.

which in reality does not exist. If the entrepreneur or the laborer, engaged in public works which are subsidized by the taxpayer, receives additional money, so that he himself is able to buy more goods or to pay higher prices, he does nothing else than to transfer a part of this subvention to others. Thus, the multiplier is really nothing else than a divisor of the subvention.

Basically, the multiplier is the very expression of the well-known fact that money is normally not hoarded, but spent, thus creating the so-called cycle of money.

XXII The Miracle of Governmentally Created Employment?

BY PROVIDING EMPLOYMENT through spending, the government does not accomplish any miracles. There are no miracles in economics. The government can undertake enterprises which the private entrepreneur is not able to, for the simple reason *that it can shift its deficit in some way or another to the community of taxpayers. There is a decrease in costs but not a direct one charged to the employees but an indirect one charged to the totality. Production is only undertaken if the return covers the costs or if somebody else pays the deficit. This fact should be the basis for every theory of government spending.*

Governmental spending alters the distribution in a cold, clandestine and dangerous way, as every inflation and large-scale monetary manipulation in general does, but with consequences not foreseen. It could only be justified if there were no other direct and honest means of

altering the distribution and of which the consequences could be foreseen.

As mentioned before, there are no miracles in inciting production. Every magnitude of production is the result of a certain state of distribution. Therefore, planning should not tend to recommend just governmental spending but should tend to find out *with which means distribution should be altered so that natural profitability is re-established in the country.*

XXIII The Theory of Compensation

THE ENORMOUS INCREASE of a governmental debt is very often considered as harmless, because the increasing debt is compensated by the increasing claims which individuals hold against the government. This argument is used equally whether deficit spending is for the conduct of war or for combating unemployment. The argument is undoubtedly very plausible to the average man and, therefore, very dangerous.

This argument has always been put forward in times of state bankruptcies as, for instance, during the French Revolution. During the German inflation it appeared as the slogan "the money remains in the country." It contributed greatly to the inflationary financial policies of the German war and post-war period, and must be considered one of the chief reasons for the monetary disaster. But we do not want to deal here with the danger of inflation. Nothing is so easy and, at the same time, so difficult to avoid as inflation. It is just a question of whether the

government has the will and the power to pursue a non-inflationary policy; theoretically, the problems are so clear that there is no reason for discussing them any longer.

In this instance we deal not with the danger of inflation but with the other economic consequences of an ever-increasing debt: In this respect does the compensation of governmental debts and claims against the government demonstrate that the debt is unobjectionable? It has, of course, never been denied that, as long as a governmental debt is held internally, debt and claim offset one another. However, this is one of the formal truths in economics which actually do not prove anything. For in order to service or repay the debt one has to take away the claims from somebody. The compensation problem is therefore a problem of distribution of assets.

XXIV Government Spending and Progressive Taxation

DISTRIBUTION PROBLEMS in a modern economy are not just problems but they are *the* problems. For distribution in a capitalist economy determines not only the nature of production but also its magnitude.

In a country in which progressive taxation is a matter of course, increasing tax burdens are not distributed equally among all concerned; they are in a progressive way imposed upon the higher incomes which are naturally entrepreneurs' incomes. Therefore, increasing governmental debts mean decreasing reward for entrepre-

neurs' risk, and, therefore, restriction of enterprise and, consequently, diminishing employment.

XXV Tax Exemptions for New Enterprises No Way Out of the Dilemma

IN CLEAR RECOGNITION of the consequences of a rising governmental debt and in order to avoid them, the interesting suggestion has been made that tax exemption be provided for newly founded enterprises.* The suggested procedure would be in line with the policy carried through in Germany after the great inflation in the field of house construction. Newly erected buildings were exempt from the so-called *Hauszinssteuer* which weighed heavily upon buildings formerly erected. This differential treatment of old and new houses was justified for, through the inflation, the owner of the old houses was released from a big part of his mortgages. This is why the system worked.

If one would treat new enterprises better than formerly established ones, without any economic justification, the encouraging effect of the tax exemption—in my opinion—would not be achieved. For, as a European proverb goes, "Anyone who lies once cannot be trusted even when telling the truth." In other words, a government which takes away the reward for risk-taking from enterprises already established, would not be trusted if it should promise tax exemption to newly founded ones. After all, entrepreneurs are also human beings who learn from experience.

* By Prof. Alvin H. Hansen, see Harper's Magazine, April, 1942.

How serious the question of tax increase in connection with new enterprises is, becomes clear if one considers that the founding of new enterprises in the usual corporate form was only possible—even under the much lower prewar rates—in cases where exceptionally high profits were expected. For the corporate taxes, as levied in this country, represent—in contrast, for instance, to Great Britain—a double taxation for the investing shareholder, so that the very moment the rates become substantial—let us say, 50%—money loses half of its value by the mere fact that it is being paid into a corporation. Even my relatively short experience in this country has already given me an opportunity to witness the restricting effect of the corporate taxation with regard to the founding of new enterprises.

The idea of differentiating between the taxation of new and old enterprises is undoubtedly logical if one wants to bring into conformity, on the one hand, heavy taxation of enterprises, and, on the other hand, a world which depends on new capitalistic ventures. In practice, however, I do not think this idea can work. It is the *crux* of all experiments toward expropriation and socialization of established wealth by taxation or other means, that it is impossible to expropriate the results of *former* industrial ventures without discouraging *new* ones.

XXVI Conclusion

THE MEANS for government spending have to be raised, ultimately, from somebody.

As far as the means are paid from the working class, what actually happens is nothing but a clandestine and

cold lowering of wages; as far as the means for the subvention are raised from the private entrepreneurs, a cumulative process develops, which leads necessarily to a progressive socialization of enterprises. For through ever-increasing taxation, more and more enterprises become unprofitable, so that the government again must replace them in their true function of providing production and employment.

Furthermore, the process leads to a socialization of consumption. The money which the owner saves, and does not spend, is taken away from him sooner or later in one way or another for production of goods which shall serve collective needs.

This has always occurred to a certain degree, such as in the case of public parks. But if production for the community's need is not undertaken for certain limited and specially defined collective purposes, but for the fight against unemployment, this must lead more and more to a loss of natural profitability, and thus to total socialization of production and consumption.

Thus vast government spending, seemingly recommended as a beneficial measure of economic policy, is in reality a measure leading to fundamental changes in the economic and social system.

It is beyond the topic of this paper to examine whether the development, which leads from the acceptance of economic rigidities to ever more governmental spending and from there to Socialism, is inevitable. No doubt, there are forces working in other directions.

Part of them urge the regulation of the whole economic process by the government, based on the idea that it is better to have all factors fixed according to a unified and centralized plan than as a result of the fight of different pressure groups. This way leads to Fascism.

The other part works in the direction of voluntarily putting the economic laws to functioning again; this is the rebuilding of a free economy so persuasively recommended, for instance, in the new book by Professor Roepke, *Gesellschaftskrise der Gegenwart*.

I personally hope that the rebuilding of a free economy is still possible.

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